EASTERN CO
Form 10-Q
October 24, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED September 27, 2014

## OR

## [ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM

## Commission File Number: 0599

THE EASTERN COMPANY
(Exact name of registrant as specified in its charter)

Connecticut
(State or other jurisdiction of incorporation or organization)

112 Bridge Street, Naugatuck, Connecticut (Address of principal executive offices)
06-0330020
(I.R.S. Employer

Identification No.)
(203) 729-2255
(Registrant's telephone number, including area code)
Not applicable
(Former name, former address and former fiscal year, if changed since last report)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was
required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No [ ]
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)

Accelerated filer [X]
Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ] No [X]
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class
Common Stock, No par value

Outstanding as of October 22, 2014
6,223,577
-1-

ITEM 1 - FINANCIAL STATEMENTS

THE EASTERN COMPANY AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

ASSETS

## Current Assets

Cash and cash equivalents \$ 21,198,789 \$ 19,988,361
Accounts receivable, less allowances: \$461,000-2014;
\$410,000-2013
Inventories
Prepaid expenses and other assets
Deferred income taxes
Total Current Assets

Property, Plant and Equipment
Accumulated depreciation

Goodwill
Trademarks
Patents, technology, and other intangibles net of accumulated amortization
TOTAL ASSETS

September 27, 2014 December 28, 2013

18,541,198 16,284,603
30,702,662 30,657,612
3,179,641 3,244,686 818,662 818,662
74,440,952 70,993,924

| $63,172,766$ | $61,849,854$ |
| :---: | :---: |
| $(36,002,525)$ | $(34,458,096)$ |
| $27,170,241$ | $27,391,758$ |


| $13,791,518$ | $13,842,047$ |
| ---: | ---: |
| 174,662 | 173,177 |
| $1,395,236$ | $1,457,503$ |
| $15,361,416$ | $15,472,727$ |
| $116,972,609 \$$ | $113,858,409$ |

\$ 116,972,609 \$ 113,858,409

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LIABILITIES AND SHAREHOLDERS' EQUITY
Current Liabilities
Accounts payable \$
Accrued compensation
Other accrued expenses
Current portion of long-term debt
Total Current Liabilities

Deferred income taxes
Other long-term liabilities
Long-term debt, less current portion
Accrued postretirement benefits
Accrued pension cost

September 27, 2014 December 28, 2013
\$ $\quad 8,589,710 \$ 7,302,368$
2,301,203 3,007,169
$1,290,712 \quad 1,519,338$
$1,785,714 \quad 1,785,714$
$13,967,339 \quad 13,614,589$

| $1,412,833$ | $1,111,755$ |
| ---: | ---: |
| 248,417 | 248,417 |
| $3,214,286$ | $4,285,714$ |
| $2,367,640$ | $2,232,872$ |
| $10,853,517$ | $10,860,211$ |

Shareholders' Equity
Voting Preferred Stock, no par value:
Authorized and unissued: 1,000,000 shares
Nonvoting Preferred Stock, no par value:
Authorized and unissued: 1,000,000 shares
Common Stock, no par value:
Authorized: 50,000,000 shares
Issued: $8,918,306$ shares in 2014 and $8,916,897$ shares in 2013
Treasury Stock: 2,694,729 shares in 2014 and 2013
Retained earnings

| $28,644,073$ | $28,621,582$ |
| :---: | :---: |
| $(19,105,723)$ | $(19,105,723)$ |
| $86,332,484$ | $83,006,671$ |

Accumulated other comprehensive income (loss):
Foreign currency translation
$1,485,885 \quad 1,983,506$
Unrecognized net pension and postretirement benefit costs, net of tax
$(12,448,142) \quad(13,001,185)$
Accumulated other comprehensive loss
Total Shareholders' Equity
$(10,962,257) \quad(11,017,679)$
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY

84,908,577

81,504,851
\$ 116,972,609 \$ 113,858,409

See accompanying notes.
-3-

## THE EASTERN COMPANY AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

|  |  | Nine Months Ended |  |  | Three Months Ended |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | September$27,2014$ |  | September | September |  | September |
|  |  |  |  | 28, 2013 | 27, 2014 |  | 28, 2013 |
| Net sales | \$ | 106,432,304 | \$ | 108,196,240 \$ | 35,803,405 | \$ | 34,256,086 |
| Cost of products sold |  | $(82,501,121)$ |  | $(86,174,409)$ | $(27,161,932)$ |  | $(27,031,677)$ |
| Gross margin |  | 23,931,183 |  | 22,021,831 | 8,641,473 |  | 7,224,409 |
| Selling and administrative |  |  |  |  |  |  |  |
| expenses |  | $(15,097,253)$ |  | $(14,671,986)$ | $(4,892,600)$ |  | $(4,767,505)$ |
| Operating profit |  | 8,833,930 |  | 7,349,845 | 3,748,873 |  | 2,456,904 |
| Interest expense |  | $(193,875)$ |  | $(249,481)$ | $(60,680)$ |  | $(78,629)$ |
| Other income |  | 37,996 |  | 36,660 | 14,030 |  | 8,201 |
| Income before income taxes |  | 8,678,051 |  | 7,137,024 | 3,702,223 |  | 2,386,476 |
| Income taxes |  | 3,049,846 |  | 2,158,699 | 1,270,406 |  | 587,693 |
| Net income | \$ | 5,628,205 | \$ | 4,978,325 \$ | 2,431,817 | \$ | 1,798,783 |
| Earnings per Share: |  |  |  |  |  |  |  |
| Basic | \$ | . 90 | \$ | . 80 \$ | . 39 | \$ | . 29 |
| Diluted | \$ | . 90 | \$ | . 80 \$ | . 39 | \$ | . 29 |
| Cash dividends per share: | \$ | .37\# | \$ | . 31 \$ | .15\# | \$ | . 11 |

\# - The Company paid an additional one-time dividend of $\$ 0.04$ per share in the third quarter of 2014.
See accompanying notes.

## THE EASTERN COMPANY AND SUBSIDIARIES <br> CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

|  | Nine Months Ended |  | Three Months Ended |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
|  | September | September | September | September |  |
| Net income | 27,2014 | 28,2013 | 27,2014 | 28,2013 |  |
| Other comprehensive | $\$$ | $5,628,205$ | $\$$ | $4,978,325$ | $2,431,817$ | | $1,798,783$ |
| :--- |
| income/(loss): |
| Change in foreign currency |

of taxes of:
2014 - \$301,078 and \$100,360,
respectively
2013 - \$442,866 and \$149,033,
respectively
Total other comprehensive income/(loss)

|  | 55,423 |  | 473,636 |  | $(260,500)$ |  |
| :--- | ---: | :--- | ---: | :---: | ---: | ---: |
| $\$$ | $5,683,628$ | $\$$ | $5,451,961 \$$ | $2,171,317$ | $\$$ | $2,271,197$ |

See accompanying notes.
-4- <br> \title{

## THE EASTERN COMPANY AND SUBSIDIARIES <br> \title{ \section*{THE EASTERN COMPANY AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)} 

 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)}}

|  | Nine Months Ended |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | September 27, 2014 |  | September 28, 2013 |  |
| Operating Activities |  |  |  |  |
| Net income | \$ | 5,628,205 | \$ | 4,978,325 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |  |  |
| Depreciation and amortization |  | 2,506,785 |  | 2,916,310 |
| Loss on sale of equipment and other assets |  | 105,511 |  | 28,065 |
| Provision for doubtful accounts |  | 71,229 |  | 76,201 |
| Deferred income taxes |  |  |  | $(1,959)$ |
| Issuance of Common Stock for directors' fees |  | 22,491 |  | 16,872 |
| Changes in operating assets and liabilities: |  |  |  |  |
| Accounts receivable |  | $(2,448,174)$ |  | $(499,335)$ |
| Inventories |  | $(207,873)$ |  | $(1,092,971)$ |
| Prepaid expenses and other |  | 56,064 |  | 201,459 |
| Prepaid pension cost |  | 865,344 |  | 1,842,832 |
| Recoverable taxes receivable |  |  |  | 1,158,632 |
| Other assets |  | $(141,478)$ |  | $(59,685)$ |
| Accounts payable |  | 1,357,742 |  | 655,352 |
| Accrued compensation |  | $(672,074)$ |  | $(960,059)$ |
| Other accrued expenses |  | $(130,173)$ |  | $(1,366,903)$ |
| Net cash provided by operating activities |  | 7,013,599 |  | 7,893,136 |
| Investing Activities |  |  |  |  |
| Purchases of property, plant and equipment |  | $(2,292,872)$ |  | $(4,160,251)$ |
| Proceeds from sales of equipment and other assets |  | 19,000 |  | - |
| Net cash used in investing activities |  | $(2,273,872)$ |  | $(4,160,251)$ |
| Financing Activities |  |  |  |  |
| Principal payments on long-term debt |  | $(1,071,428)$ |  | $(1,071,429)$ |
| Proceeds from sales of Common Stock |  | - |  | 13,580 |
| Dividends paid |  | $(2,302,391)$ |  | $(1,928,439)$ |
| Net cash used in financing activities |  | $(3,373,819)$ |  | $(2,986,288)$ |
| Effect of exchange rate changes on cash |  | $(155,480)$ |  | $(147,996)$ |
| Net change in cash and cash equivalents |  | 1,210,428 |  | 598,601 |
| Cash and cash equivalents at beginning of period |  | 19,988,361 |  | 18,482,144 |
| Cash and cash equivalents at end of period | \$ | 21,198,789 | \$ | 19,080,745 |

See accompanying notes.

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-5-

THE EASTERN COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
September 27, 2014

Note A - Basis of Presentation
The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by generally accepted accounting principles in the United States for complete financial statements. Refer to the Company's consolidated financial statements and notes thereto included in its Form 10-K for the year ended December 28, 2013 for additional information.

The accompanying condensed consolidated financial statements are unaudited. However, in the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the results of operations for interim periods have been reflected therein. All intercompany accounts and transactions are eliminated. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year.

The condensed consolidated balance sheet as of December 28, 2013 has been derived from the audited consolidated balance sheet at that date.

Note B - Earnings Per Share
The denominators used in the earnings per share computations follow:

|  | Nine Months Ended |  |  |
| :--- | :---: | ---: | :---: | :---: |
| September 27, | Three Months Ended |  |  |
| Septer 28, | September 27, <br> September 28, |  | 2013 |

Note C - Inventories
The components of inventories follow:

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Raw material and component parts
Work in process
Finished goods

| $\$ 8,259,016$ |  | $\$, 256,977$ |
| ---: | ---: | ---: | ---: |
| $4,943,129$ |  | $4,925,001$ |
| $17,500,517$ |  | $17,475,634$ |
| $\$ 30,702,662$ |  | $\$ 30,657,612$ |

-6-

Note D - Segment Information
Segment financial information follows:

|  |  | Nine Months Ended |  |  | Three Months Ended |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | September 27, $2014$ | September 28, 2013 |  | $\begin{gathered} \text { September 27, } \\ 2014 \end{gathered}$ |  | September 28, 2013 |  |
| Revenues: |  |  |  |  |  |  |  |  |
| Sales to unaffiliated customers: |  |  |  |  |  |  |  |  |
| Industrial Hardware | \$ | 44,202,346 | \$ | 46,682,686 | \$ | 15,006,948 | \$ | 15,067,122 |
| Security Products |  | 37,748,241 |  | 36,647,899 |  | 12,780,359 |  | 12,690,410 |
| Metal Products |  | 24,481,717 |  | 24,865,655 |  | 8,016,098 |  | 6,498,554 |
|  | \$ | 106,432,304 | \$ | 108,196,240 | \$ | 35,803,405 | \$ | 34,256,086 |
| Income before |  |  |  |  |  |  |  |  |
| income taxes: |  |  |  |  |  |  |  |  |
| Hardware | \$ | 3,994,443 | \$ | 3,507,935 | \$ | 1,428,040 | \$ | 1,444,830 |
| Security Products |  | 3,088,610 |  | 1,737,150 |  | 1,643,159 |  | 499,717 |
| Metal Products |  | 1,750,877 |  | 2,104,760 |  | 677,674 |  | 512,357 |
| Operating Profit |  | 8,833,930 |  | 7,349,845 |  | 3,748,873 |  | 2,456,904 |
| Interest expense |  | $(193,875)$ |  | $(249,481)$ |  | $(60,680)$ |  | $(78,629)$ |
| Other income |  | 37,996 |  | 36,660 |  | 14,030 |  | 8,201 |
|  | \$ | 8,678,051 | \$ | 7,137,024 | \$ | 3,702,223 | \$ | 2,386,476 |

## Note E - Recent Accounting Pronouncements

In April 2014, the FASB issued authoritative guidance which changes the criteria for determining which disposals can be presented as discontinued operations and modifies the related disclosure requirements. To qualify as a discontinued operation the standard requires a disposal to represent a strategic shift that has, or will have, a major effect on an entity's operations and financial results. The standard also expands the disclosures for discontinued operations and requires new disclosures related to individually material dispositions that do not qualify as discontinued operations. The guidance is effective for fiscal years beginning after December 15, 2014, with early adoption permitted. The Company will adopt this guidance with its fiscal year effective January 4, 2015 and does not expect any impact on the consolidated financial statements of the Company. This guidance will impact the reporting of any future dispositions.

In May 2014, the FASB issued authoritative guidance which impacts virtually all aspects of an entity's revenue recognition. The core principle of the new standard is that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The Company has not determined the impact of the adoption of this guidance on the consolidated financial statements of the Company.

The Company has implemented all new accounting pronouncements that are in effect and that could impact its consolidated financial statements and does not believe that there are any other new accounting pronouncements that
have been issued, but are not yet effective, that might have a material impact on the consolidated financial statements of the Company.
-7-

Note F - Debt
On January 29, 2010, the Company signed a secured Loan Agreement (the "Loan Agreement") with People's United Bank ("People's") which included a $\$ 5,000,000$ term portion (the "Original Term Loan") and a $\$ 10,000,000$ revolving credit portion. On January 25, 2012, the Company amended the loan agreement by taking an additional $\$ 5,000,000$ term loan (the " 2012 Term Loan"). Interest on the Original Term Loan portion of the Loan Agreement is fixed at $4.98 \%$. Interest on the 2012 Term Loan is fixed at $3.90 \%$. The interest rate on the revolving credit portion of the Loan Agreement varied based on the LIBOR rate plus a margin spread of $2.25 \%$, with a floor rate of $3.25 \%$ or People's Prime rate and a maturity date of January 31, 2014. On January 23, 2014, the Company signed an amendment to its secured Loan Agreement with People's which extended the maturity date of the $\$ 10,000,000$ revolver portion of the Loan Agreement to July 1, 2016 and changed the interest rate to LIBOR plus $2.25 \%$, eliminating the floor previously in place, or People's Prime rate. The Company did not utilize the revolving credit facility during Fiscal 2013 or during the first nine months of Fiscal 2014.

The Company has loan covenants under the Loan Agreement which require the Company to maintain a fixed charge coverage ratio of at least 1.1 to 1 , a leverage ratio of no more than 1.75 to 1 , and minimum tangible net worth of $\$ 43$ million as of the end of Fiscal 2010 increasing each year by $50 \%$ of consolidated net income. This amount was approximately $\$ 52.8$ million for Fiscal 2013. As part of the amendment signed on January 23, 2014, the leverage ratio was eliminated and the minimum tangible net worth covenant was modified to a fixed $\$ 55$ million, effective as of March 29, 2014. In addition, the Company has restrictions on, among other things, new capital leases, purchases or redemptions of its capital stock, mergers and divestitures, and new borrowing. The Company was in compliance with all covenants in 2013 and for the nine month period ended September 27, 2014.

Note G - Goodwill
The following is a roll-forward of goodwill from year-end 2013 to the end of the third quarter 2014:

| Industrial | Security | Metal |  |
| :---: | :---: | :---: | :---: |
| Hardware | Products | Products |  |
| Segment | Segment | Segment | Total |


| Beginning balance | \$ | 2,008,231 | \$ | 11,833,816 | \$ | -\$ | 13,842,047 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| F ore i g n exchange |  | (50,529) |  |  |  |  | $(50,529)$ |
| Ending balance | \$ | 1,957,702 | \$ | 11,833,816 | \$ | -\$ | 13,791,518 |

Note H - Intangibles
Patents are recorded at cost and are amortized using the straight-line method over the lives of the patents. Technology and licenses are recorded at cost and are generally amortized on a straight-line basis over periods ranging from 5 to 17 years. Non-compete agreements and customer relationships are being amortized using the straight-line method over a period of 5 years. Trademarks are not amortized as their lives are deemed to be indefinite.

The gross carrying amount and accumulated amortization of amortizable intangible assets:

2014 Patents and developed technology $\begin{array}{llllllll}\text { Gross Amount: } & \$ & 2,582,456 & \$ & 1,062,380 & \$ & -- & 3,644,836\end{array}$ Accumulated Amortization:
Net September 27, 2014 $\begin{array}{llllll}\text { per Balance Sheet } \$ 891,746 \$ 1503,490 \$ & --\$ 1,395,236\end{array}$

2013 Patents and
developed technology

Gross Amount:
Accumulated
Amortization:
Net December 28, 2013
per Balance Sheet $\$$ 919,491 \$ 538,012 \$ -- \$ 1,457,503

## Note I - Retirement Benefit Plans

The Company has non-contributory defined benefit pension plans covering certain U.S. employees. Plan benefits are generally based upon age at retirement, years of service and, for its salaried plan, the level of compensation. The Company also sponsors unfunded nonqualified supplemental retirement plans that provide certain current and former officers with benefits in excess of limits imposed by federal tax law.

The Company also provides health care and life insurance for retired salaried employees in the United States who meet specific eligibility requirements.

Significant disclosures relating to these benefit plans for the third quarter and first nine months of fiscal 2014 and 2013 follow:

|  | Pension Benefits |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Nine Months Ended |  |  |  | Three Months Ended |  |  |  |
|  | September 27,$2014$ |  | September 28, |  | September 27, 2014 |  | September 28, |  |
| Service cost | \$ | 2,095,271 | \$ | 2,259,723 | \$ | 698,423 | \$ | 755,661 |
| Interest cost |  | 2,487,835 |  | 2,130,467 |  | 829,278 |  | 710,350 |
| Expected return on plan assets |  | $(3,607,894)$ |  | $(3,302,736)$ |  | $(1,202,632)$ |  | $(1,100,912)$ |
| Amortization of prior service |  |  |  |  |  |  |  |  |
| cost |  | 163,940 |  | 192,345 |  | 54,647 |  | 69,630 |
| Amortization of the net loss |  | 708,098 |  | 1,065,295 |  | 236,033 |  | 353,579 |
| Net periodic benefit cost | \$ | 1,847,250 | \$ | 2,345,094 | \$ | 615,749 | \$ | 788,308 |


|  | Postretirement Benefits |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Nine Months Ended |  |  |  | Three Months Ended |  |  |  |
|  | September 27, |  | September28 |  |  |  |  |  |
|  |  |  | September 27, | September 28, |  |
| Service cost | \$ | 130,427 |  |  | \$ | 151,926 | \$ | 43,476 | \$ | 50,642 |
| Interest cost |  | 118,112 |  | 106,565 |  | 39,371 |  | 35,522 |
| Expected return on plan assets |  | $(71,109)$ |  | $(73,041)$ |  | $(23,703)$ |  | $(24,347)$ |
| Amortization of prior service cost |  | $(17,917)$ |  | $(17,916)$ |  | $(5,972)$ |  | $(5,972)$ |
| Amortization of the net loss |  | -- |  | 14,145 |  | -- |  | 4,715 |
| Net periodic benefit cost | \$ | 159,513 | \$ | 181,679 | \$ | 53,172 | \$ | 60,560 |

-9-

The Company's funding policy with respect to its qualified plans is to contribute at least the minimum amount required by applicable laws and regulations. In 2014, the Company expects to contribute $\$ 2.5$ million into its pension plans and $\$ 63,000$ into its postretirement plan. As of September 27, 2014, the Company has made contributions totaling approximately $\$ 970,000$ into its pension plans and $\$ 43,000$ to its postretirement plan and will make the remaining contributions as required during the remainder of the year.

The Company has a contributory savings plan under Section 401(k) of the Internal Revenue Code covering substantially all U.S. non-union employees. The plan allows participants to make voluntary contributions of up to $100 \%$ of their annual compensation on a pretax basis, subject to IRS limitations. The plan provides for contributions by the Company at its discretion. The Company made contributions of $\$ 49,975$ and $\$ 153,431$ in the third quarter and first nine months of 2014, respectively and $\$ 48,062$ and $\$ 148,797$ in the third quarter and first nine months of 2013, respectively.

## Note J - Stock Based Compensation and Stock Options

The Company has stock option plans for officers, other key employees, and non-employee directors. As of September 27, 2014 two plans have shares reserved for future issuance, the 1995 and 2010 plans. Incentive stock options granted under the 1995 and 2010 plans must have exercise prices that are not less than $100 \%$ of the fair market value of the stock on the dates the options are granted. Restricted stock awards may also be granted to participants under the 2010 plan with restrictions determined by the Compensation Committee of the Company's Board of Directors. Under the 1995 and 2010 plans, nonqualified stock options granted to participants will have exercise prices determined by the Compensation Committee of the Company's Board of Directors. No options or restricted stock were granted in the first nine months of 2014 or 2013.

As of September 27, 2014, there were 500,000 shares available for future grant under the above noted 2010 plan and there were no shares available for grant under the 1995 plan. As of September 27, 2014, there were 520,000 shares of common stock reserved under all option plans for future issuance.


Options Outstanding and Exercisable

|  | Weighted- |  |
| :---: | :---: | :---: |
|  | Average | Weighted- |
| Range of $\quad$ Outstanding as of | Remaining | Average |
| Exercise Prices | September 27, 2014Contractual Life | Exercise Price |


|  | Edgar Filing: EASTERN CO - Form 10-Q |  |  |
| :---: | :---: | :---: | :---: |
| $\$ 13.58$ | 20,000 | 0.2 | $\$ 13.580$ |

At September 27, 2014, outstanding and exercisable options had an intrinsic value of $\$ 38,000$.

Note K - Income Taxes

The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2011 and non-U.S. income tax examinations by tax authorities prior to 2008. During the third quarter of 2013, the Internal Revenue Service completed its examination of the tax returns for Fiscal Years 2010 and 2011. There were no changes to the Company's financial statements as a result of this audit. -10-

During the first nine months of Fiscal 2014, the Company repatriated approximately $\$ 2.8$ million in cash from its foreign subsidiaries. The impact of this has been an increase in the effective tax rate by approximately $1.4 \%$.

The total amount of unrecognized tax benefits could increase or decrease within the next twelve months for a number of reasons, including the closure of federal, state and foreign tax years by expiration of the statute of limitations and the recognition and measurement considerations under FASB Accounting Standards Codification ("ASC") 740. There have been no significant changes to the amount of unrecognized tax benefits during the three or nine month period ended September 27, 2014. As a result of the expiration of the statute of limitations in various state jurisdictions, the Company recorded a net tax benefit of $\$ 18,850$. This net tax benefit resulted from the release of unrecognized tax benefits related to state income tax nexus issues and the associated accrued interest. The Company believes that it is reasonably possible that the total amount of unrecognized tax benefits will not increase or decrease significantly over the next twelve months.

Note L - Financial Instruments and Fair Value Measurements
Financial Risk Management Objectives and Policies
The Company is exposed primarily to credit, interest rate and currency exchange rate risks which arise in the normal course of business.

## Credit Risk

Credit risk is the potential financial loss resulting from the failure of a customer or counterparty to settle its financial and contractual obligations to the Company, as and when they become due. The primary credit risk for the Company is its receivable accounts with customers. The Company has established credit limits for customers and monitors their balances to mitigate the risk of loss. At September 27, 2014 and December 28, 2013, there were no significant concentrations of credit risk. No one customer represented more than $10 \%$ of the Company's net trade receivables at September 27, 2014 or at December 28, 2013. The maximum exposure to credit risk is primarily represented by the carrying amount of the Company's accounts receivable.

Interest Rate Risk
On September 27, 2014, the Company has no exposure to the risk of changes in market interest rates as the interest rate on the outstanding debt is fixed at $4.98 \%$ and $3.90 \%$.

Fair Value Measurements
Assets and liabilities that require fair value measurement are recorded at fair value using market and income valuation approaches and considering the Company's and counterparty's credit risk. The Company uses the market approach and the income approach to value assets and liabilities as appropriate. There are no assets or liabilities requiring fair value measurements on September 27, 2014 or December 28, 2013.

## ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is intended to highlight significant changes in the Company's financial position and results of operations for the thirty-nine weeks ended September 27, 2014. The interim financial statements and this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements and Notes thereto for the fiscal year ended December 28, 2013 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2013.

Certain statements set forth in this discussion and analysis of financial condition and results of operations are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. They use such words as "may," "will," "expect," "believe," "plan" and other similar terminology. These statements reflect manageme current expectations regarding future events and operating performance and speak only as of the date of this release. These forward-looking statements involve a number of risks and uncertainties, and actual future results and trends may differ materially depending on a variety of factors, including changing customer preferences, lack of success of new products, loss of customers, competition, increased raw material prices, problems associated with foreign sourcing of parts and products, changes within our industry segments and in the overall economy, litigation and legislation. In addition, terrorist threats and the possible responses by the U.S. government, the effects on consumer demand, the financial markets, the travel industry, the trucking industry and other conditions increase the uncertainty inherent in forward-looking statements. Forward-looking statements reflect the expectations of the Company at the time they are made, and investors should rely on them only as expressions of opinion about what may happen in the future and only at the time they are made. The Company undertakes no obligation to update any forward-looking statement. Although the Company believes it has an appropriate business strategy and the resources necessary for its operations, future revenue and margin trends cannot be reliably predicted and the Company may alter its business strategies to address changing conditions.

In addition, the Company makes estimates and assumptions that may materially affect reported amounts and disclosures. These relate to valuation allowances for accounts receivable and for excess and obsolete inventories, accruals for pensions and other postretirement benefits (including forecasted future cost increases and returns on plan assets), provisions for depreciation (estimating useful lives), uncertain tax positions, and, on occasion, accruals for contingent losses.

## Recent Developments

On July 23, 2014, the Board of Directors of the Company voted to pay an additional one-time extra dividend of four cents ( $\$ 0.04$ ) per share along with the regular quarterly dividend payment of eleven cents ( $\$ 0.11$ ) per share in the third quarter of 2014. The third quarter 2014 dividend payment represented the 296th consecutive quarterly dividend.

## Overview

Sales in the third quarter of 2014 increased $5 \%$ compared to the third quarter of 2013, which was the result of an increase of $3 \%$ in sales of existing products in many of the markets we serve and an increase of $2 \%$ from the introduction of new products. In the third quarter of 2014 Industrial Hardware sales were comparable to the prior year period, Metal Products sales increased $23 \%$ and Security Products sales increased $1 \%$ compared to the prior year period.

Gross margin as a percentage of sales for the three months ended September 27, 2014 was $24 \%$ compared to $21 \%$ in the comparable period a year ago. The increase was the result of changes in cost of products sold, the mix of products produced and higher sales volume causing higher utilization of the Company's production capacity in the 2014 period.
-12-

Sales in the first nine months of 2014 decreased $2 \%$ compared to the prior year period, which was primarily the result of a decrease of $4 \%$ in sales of existing products in many of the markets we serve. The decrease was offset in part by the introduction of new products which increased sales by $2 \%$. Sales decreased in the first nine months of 2014 by $5 \%$ in the Industrial Hardware segment and by $2 \%$ in the Metal Products segment, and increased by $3 \%$ in the Security Products segment compared to the prior year period.

Gross margin as a percentage of sales for the nine months ended September 27, 2014 was $23 \%$ compared to $20 \%$ in the comparable period a year ago. This increase was the result of changes in cost of products sold and the mix of products produced.

Raw material prices have increased compared to the prior year periods. The Company, through price increases, is recovering these additional costs from our customers, wherever possible. The Company expects that raw material prices will continue to increase as worldwide economic conditions improve, which may have a negative impact on future operating margins if not recovered by price increases. Currently, there is no indication that the Company will be unable to obtain supplies of all the raw materials that it requires.

Cash flow from operations in the first nine months of 2014 decreased compared to the same period in 2013. This decrease is primarily due to the timing differences in the collections of accounts receivable, payments of liabilities, and changes in inventories. Cash on hand, cash flow from operations, along with the result of controlling discretionary expenditures, should enable the Company to meet all its existing obligations and continue its quarterly dividend payments.

A more detailed analysis of the Company's results of operations and financial condition follows:

## Results of Operations

The following table shows, for the periods indicated, selected line items from the condensed consolidated statements of operations as a percentage of net sales, by segment:

|  | Three Months Ended September 27, 2014 |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
|  | Industrial | Security | Metal |  |  |
|  | Hardware | Products | Products | Total |  |
| Net sales | $100.0 \%$ | $100.0 \%$ | $100.0 \%$ | $100.0 \%$ |  |
| Cost of products sold | $74.4 \%$ | $71.8 \%$ | $85.1 \%$ | $75.9 \%$ |  |
| Gross margin | $25.6 \%$ | $28.2 \%$ | $14.9 \%$ | $24.1 \%$ |  |
|  |  |  |  |  |  |
| Selling and administrative expense | $16.1 \%$ | $15.3 \%$ | $6.5 \%$ | $13.6 \%$ |  |
| Operating profit | $9.5 \%$ | $12.9 \%$ | $8.4 \%$ | $10.5 \%$ |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  | Three Months Ended September 28, 2013 |  |  |  |  |

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Operating profit
9.6\%
4.0\%
7.9\%
7.2\%
-13-

The following table shows the amount of change for the third quarter of 2014 compared to the third quarter of 2013 in sales, cost of products sold, gross margin, selling and administrative expenses and operating profit, by segment (dollars in thousands):

| Net sales | Industrial <br> Hardware | Security <br> Products | Metal Products | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | \$ (60) | \$ 90 | \$ 1,517 |  | \$ 1,547 |
| Volume | -2.2\% | -0.3\% | 21.4\% |  | 3.0\% |
| Prices | -0.2\% | 0.4\% | -0.3\% |  | 0.0\% |
| New products | 2.0\% | 0.6\% | 2.3\% |  | 1.5\% |
|  | -0.4\% | 0.7\% | 23.4\% |  | 4.5\% |
| Cost of products sold | \$ (121) | \$ (1,108) | \$ 1,359 |  | \$ 130 |
|  | -1.1\% | -10.8\% | 24.9\% |  | 0.5\% |
| Gross margin | \$ 61 | \$ 1,198 | \$ 158 |  | \$ 1,417 |
|  | 1.6\% | 49.7\% | 15.2\% |  | 19.6\% |
| Selling and administrative expenses | \$ 78 | \$ 54 | \$ (7) |  | \$ 125 |
|  | 3.3\% | 2.8\% | -1.3\% |  | 2.6\% |
| Operating profit | \$ (17) | \$ 1,144 | \$ 165 |  | \$ 1,292 |
|  | -1.2\% | 228.8\% | 32.3\% |  | 52.6\% |

The following table shows, for the periods indicated, selected line items from the condensed consolidated statements of income as a percentage of net sales, by segment:

|  | Nine Months Ended September 27, 2014 |  |  |  |
| :--- | ---: | ---: | ---: | ---: |
|  | Industrial | Security | Metal |  |
|  | Hardware | Products | Products | Total |
| Net sales | $100.0 \%$ | $100.0 \%$ | $100.0 \%$ | $100.0 \%$ |
| Cost of products sold | $74.5 \%$ | $75.6 \%$ | $85.8 \%$ | $77.5 \%$ |
| Gross margin | $25.5 \%$ | $24.4 \%$ | $14.2 \%$ | $22.5 \%$ |
|  |  |  |  |  |
| Selling and administrative expense | $16.5 \%$ | $16.2 \%$ | $7.0 \%$ | $14.2 \%$ |
| Operating profit | $9.0 \%$ | $8.2 \%$ | $7.2 \%$ | $8.3 \%$ |


|  | Het sales | $100.0 \%$ | $100.0 \%$ | $100.0 \%$ |
| :--- | ---: | ---: | ---: | ---: |
| Post of products sold | $77.2 \%$ | $79.5 \%$ | $84.6 \%$ | $700.0 \%$ |
| Gross margin | $22.8 \%$ | $20.5 \%$ | $15.4 \%$ | $20.6 \%$ |
|  |  |  |  |  |
| Selling and administrative expense | $15.3 \%$ | $15.8 \%$ | $7.0 \%$ | $13.6 \%$ |
| Operating profit | $7.5 \%$ | $4.7 \%$ | $8.4 \%$ | $6.8 \%$ |

The following table shows the amount of change for the first nine months of 2014 compared to the first nine months of 2013 in sales, cost of products sold, gross margin, selling and administrative expenses and operating profit, by segment (dollars in thousands):

| Net sales | Industrial <br> Hardware | Security <br> Products | Metal <br> Products | Total |
| :---: | :---: | :---: | :---: | :---: |
|  | \$ $(2,480)$ | \$ 1,100 | \$ (384) | \$ $(1,764)$ |
| Volume | -8.2\% | 1.8\% | -3.9\% | -3.8\% |
| Prices | -0.1\% | 0.2\% | -0.2\% | 0.0\% |
| New products | 3.0\% | 1.0\% | 2.6\% | 2.2\% |
|  | -5.3\% | 3.0\% | -1.5\% | -1.6\% |
| Cost of products sold | \$ $(3,088)$ | \$ (567) | \$ (18) | \$ $(3,673)$ |
|  | -8.6\% | -1.9\% | -0.1\% | -4.3\% |
| Gross margin | \$ 608 | \$ 1,667 | \$ (366) | \$ 1,909 |
|  | 5.7\% | 22.1\% | -9.5\% | 8.7\% |
| Selling and administrative expenses | \$ 121 | \$ 316 | \$ (12) | \$ 425 |
|  | 1.7\% | 5.5\% | -0.7\% | 2.9\% |
| Operating profit | \$ 487 | \$ 1,351 | \$ (354) | \$ 1,484 |
|  | 13.9\% | 77.8\% | -16.8\% | 20.2\% |

## Industrial Hardware Segment

Net sales in the Industrial Hardware segment were comparable in the third quarter of 2014 and 2013 and decreased $5 \%$ in the first nine months compared to the prior year period. The decrease in sales in the first nine months of 2014 reflected a decrease in sales of existing products, primarily lightweight composite panels which were used in the fracking industry, as well as lower sales to our distributors and military markets in 2014 compared to the prior year periods. The decrease in sales of the lightweight composite panels for the fracking tank was the result of a customer exiting the fracking business. The overall decrease in sales in the first nine months of 2014 were offset by an increase in sales to several of the markets we sell into, including: the Class 8 truck, truck accessory, off-highway, bus, and industrial markets compared to the same period in 2013 and the introduction of new products. All of the new products were developed internally and included a cab handle and paddle, a rotary and lever arm, a lever assembly, a paddle lock, a striker pin, luggage latch and a trigger latch for the Class 8 truck market; a rotary, a mini rotary and a gate lock for the off-highway market; a trigger latch for the bus market; a 3 point compression latch, a stainless steel catch, a trigger latch, an ergonomic t-handle, and a paddle assembly for the distribution market; a striker and rotary, a rotary lock and a paddle rotary for the industrial market; as well as a variety of locking and latching products for the many markets we serve.

Cost of products sold for the Industrial Hardware segment decreased $\$ 0.1$ million or $1 \%$ in the third quarter and $\$ 3.1$ million or $9 \%$ in the first nine months of 2014 compared to the same periods in 2013.

The most significant factors resulting in changes in cost of products sold in the third quarter of 2014 compared to the 2013 third quarter included:
§ an increase of \$0.1 million or $101 \%$ in foreign currency exchange;
§ an increase of $\$ 0.1$ million or $48 \%$ in miscellaneous income; § a decrease of $\$ 0.2$ million or $33 \%$ in depreciation costs; § and a decrease of $\$ 0.1$ million or $3 \%$ in costs for payroll and payroll related charges.
-15-

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The most significant factors resulting in changes in cost of products sold in the first nine months of 2014 compared to the 2013 period included:
$\S$ an increase of $\$ 0.1$ million or $116 \%$ in foreign currency exchange;
$\S$ an increase of $\$ 0.1$ million or $62 \%$ in engineering expense;
$\S$ an increase of $\$ 0.1$ million or $7 \%$ in supplies and tools;
$\S$ a decrease of $\$ 2.2$ million or $10 \%$ in raw materials;
$\S$ a decrease of $\$ 0.4$ million or $32 \%$ in depreciation expense;
$\S$ a decrease of $\$ 0.4$ million or $5 \%$ in costs for payroll and payroll related charges;
$\S$ a decrease of $\$ 0.2$ million or $53 \%$ in miscellaneous income;
$\S$ a decrease of $\$ 0.1$ million or $12 \%$ in other shipping expenses;
$\S$ and a decrease of $\$ 0.1$ million or $17 \%$ in rent expense.

Gross margin as a percentage of sales in the third quarter increased to $26 \%$ in 2014 from $25 \%$ in the prior year period and increased in the first nine months to $26 \%$ from $23 \%$ in the prior year period. The increases in gross margin for both the third quarter and first nine months of 2014 reflect the mix of products produced and the changes to cost of products sold discussed above.

Selling and administrative expenses in the Industrial Hardware segment increased $\$ 0.1$ million or $3 \%$ in the third quarter and increased $\$ 0.1$ million or $2 \%$ in the first nine months of 2014 as compared to the 2013 periods.

The most significant factor resulting in changes in selling and administrative expenses in the Industrial Hardware segment in the third quarter of 2014 compared to the 2013 third quarter included:
§ an increase of \$0.1 million or 7\% in costs for payroll and payroll related charges.
The most significant factor resulting in changes in selling and administrative expenses in the Industrial Hardware segment in the first nine months of 2014 compared to the 2013 period included:
§ an increase of \$0.1 million or $1 \%$ in costs for payroll and payroll related charges.

## Security Products Segment

Net sales in the Security Products segment increased $1 \%$ in the third quarter and 3\% in the first nine months of 2014 compared to the 2013 periods. The increase in sales in the third quarter of 2014 compared to the 2013 period was primarily the result of new lock products to the many markets we serve. The increase in the first nine months of 2014 compared to the prior year period was the result of higher sales volume of existing products primarily to the commercial laundry market and the introduction of new lock products to the many markets we serve. Sales of new products included a flush mount handle for tonneau covers, a locking T-handle for truck caps and cable and stud locks for bicycle racks for the vehicular market and a custom brass padlock, a rekeyable padlock for the locksmith market and a passive keyless entry system for the storage market.

Cost of products sold for the Security Products segment decreased $\$ 1.1$ million or $11 \%$ in the third quarter and decreased $\$ 0.6$ million or $2 \%$ in the first nine months of 2014 compared to the same periods in 2013.

The most significant factors resulting in changes in cost of products sold in the third quarter of 2014 compared to the 2013 third quarter included:
§ an increase of $\$ 0.3$ million or $18 \%$ in payroll and payroll related charges;
$\S$ an increase of $\$ 0.3$ million or $1,354 \%$ in shipping expenses;
§ an increase of $\$ 0.1$ million or $27 \%$ in supplies and tools;
§ an increase of $\$ 0.1$ million or $115 \%$ in costs for fire and liability insurance;
$\S$ an increase of $\$ 0.1$ million or $284 \%$ in miscellaneous taxes;
$\S$ a decrease of $\$ 0.6$ million or $100 \%$ in severance costs for relocation of a facility in China which occurred in the 2013 period;
§ and a decrease of $\$ 1.4$ million or $20 \%$ in raw materials.
-16-

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The most significant factors resulting in changes in cost of products sold in the first nine months of 2014 compared to the 2013 period included:
§ an increase of $\$ 0.9$ million or $18 \%$ in payroll and payroll related charges;
$\S$ an increase of $\$ 0.6$ million or $672 \%$ in shipping expenses;
§ an increase of $\$ 0.2$ million or $35 \%$ in supplies and tools;
§ an increase of $\$ 0.2$ million or $392 \%$ in freight on sales;
$\S$ an increase of $\$ 0.1$ million or $88 \%$ in costs for fire and liability insurance;
§ an increase of $\$ 0.1$ million or $1,606 \%$ for rental equipment;
§ an increase of $\$ 0.1$ million or $160 \%$ related to costs for maintenance and repairs;
$\S$ an increase of $\$ 0.1$ million or $129 \%$ in miscellaneous taxes;
§ a decrease of $\$ 0.1$ million or $60 \%$ for tools and jigs;
§ a decrease of $\$ 0.6$ million or $100 \%$ in severance costs for relocation of a facility in China;
§ and a decrease of $\$ 2.2$ million or $11 \%$ in raw materials.
Gross margin as a percentage of sales in the third quarter increased to $28 \%$ in 2014 from 19\% in the prior year period and in the first nine months to $24 \%$ from $21 \%$ in the prior year period. The increases in both the third quarter and first nine months of 2014 reflect the mix of products produced and the changes in cost of products sold discussed above as well as the higher sales volume in the first nine months compared to the 2013 period.

Selling and administrative expenses in the Security Products segment increased $\$ 0.1$ million or $3 \%$ in the third quarter and $\$ 0.3$ million or $6 \%$ in the first nine months of 2014 as compared to the 2013 periods.

The most significant factor resulting in changes in selling and administrative expenses in the Security Products segment in the third quarter of 2014 compared to the 2013 third quarter included:
§ an increase of $\$ 0.1$ million or $5 \%$ in costs for payroll and payroll related charges.
The most significant factor resulting in changes in selling and administrative expenses in the Security Products segment in the first nine months of 2014 compared to the 2013 period included:
§ an increase of $\$ 0.3$ million or $6 \%$ in costs for payroll and payroll related charges.

## Metal Products Segment

Net sales in the Metal Products segment increased 23\% in the third quarter and decreased $2 \%$ in the first nine months of 2014 as compared to the prior year periods. The increase in sales in the third quarter of 2014 compared to the prior year period was the result of higher sales of existing products to both the contract casting and mining markets and the introduction of new products. The decrease in sales in the first nine months of 2014 was primarily the result of lower sales of existing products to the mining market. The decrease in the first nine months of 2014 was reduced by the introduction of new products. New mining products included a cable head, a shell and a small hole flange nut. Sales of mining products were up $17 \%$ in the third quarter resulting from stronger demand in both the U.S. and Canadian mining markets compared to the 2013 period. Sales were down $7 \%$ in the first nine months of 2014 compared to the prior year period, the result of weaker demand in the first half of 2014 in both the U.S. and Canadian mining markets. Sales of contract castings increased $64 \%$ in the third quarter and $42 \%$ in the first nine months of 2014 from the prior year levels. The increase in sales of contract castings was primarily the result of increased sales of existing products to the solar and vehicular markets. Contract casting sales also benefited from the sales of a new rail clamp
product for a solar panel application and nuts for the utility market.
-17-

Cost of products sold for the Metal Products segment increased $\$ 1.4$ million or $25 \%$ in the third quarter of 2014 compared to the prior year period and were comparable in the first nine months of 2014 and 2013.

The most significant factors resulting in changes in cost of products sold in the third quarter of 2014 compared to the 2013 third quarter included:
§ an increase of $\$ 1.9$ million or $427 \%$ in raw materials;
§ a decrease of $\$ 0.2$ million or $35 \%$ related to costs for maintenance and repairs;
$\S$ and a decrease of $\$ 0.3$ million or $11 \%$ in costs for payroll and payroll related charges.
The most significant factors resulting in changes in cost of products sold in the first nine months of 2014 compared to the 2013 period included:
§ an increase of $\$ 0.7$ million or $14 \%$ in raw materials; § an increase of $\$ 0.1$ million or $3 \%$ in supplies and tools;
§ an increase of $\$ 0.1$ million or $8 \%$ in utility costs;
§ a decrease of $\$ 0.8$ million or $9 \%$ in costs for payroll and payroll related charges;
$\S$ and a decrease of $\$ 0.1$ million or $7 \%$ related to costs for maintenance and repairs.
Gross margin as a percentage of net sales decreased to $15 \%$ in the third quarter of 2014 from $16 \%$ in the prior year period and to $14 \%$ in the first nine months of 2014 from $15 \%$ in the 2013 period. The decreases in both the third quarter and first nine months of 2014 are due to the mix of products produced as well as the changes in cost of products sold discussed above.

Selling and administrative expenses in the Metal Products segment were comparable for the third quarter and first nine months of 2014 and 2013.

## Other Items

Interest expense decreased $23 \%$ in the third quarter and $22 \%$ in the first nine months of 2014 compared to the prior year period due to the decreased level of debt in 2014.

Other income was not material to the financial statements.

Income taxes reflected the change in the operating results. The effective tax rate in the third quarter was $34 \%$ compared to the prior year period of $25 \%$ and in the first nine months of 2014 was $35 \%$ compared to $30 \%$ in the 2013 period. The higher rates in 2014 also reflect taxes paid on the repatriation of approximately $\$ 2.8$ million of cash from foreign subsidiaries.
-18-

Liquidity and Sources of Capital
The Company generated $\$ 7.0$ million of cash from its operations during the first nine months of 2014 compared to $\$ 7.9$ million during the same period in 2013. The decrease in cash flows in the quarter was primarily the result of the associated timing differences in the collections of accounts receivable, payments of liabilities, and changes in inventories. Cash flow from operations coupled with cash on hand at the beginning of the year was sufficient to fund capital expenditures, debt service, and dividend payments.

Additions to property, plant and equipment were $\$ 2.3$ million for the first nine months of 2014 compared to $\$ 4.2$ million for the same period in 2013. Total capital expenditures for 2014 are expected to be approximately $\$ 3$ to $\$ 3.5$ million. As of September 27, 2014, there is approximately $\$ 725,000$ of outstanding commitments for the remaining capital expenditures.

The following table shows key financial ratios at the end of each period:

|  | Third <br> Quarter <br> Quard | Third <br> Quarter | Year <br> End |  |
| :--- | :--- | :--- | :--- | :--- |
|  | 2014 | 2013 | 2013 |  |

The following table shows important liquidity measures as of the balance sheet date for each period below (in millions):

|  | Third <br> Quarter <br> 2014 | Third <br> Quarter <br> 2013 | Year <br> End <br> 2013 |
| :--- | ---: | ---: | ---: |
| Cash and cash equivalents | $\$ 11.3$ | $\$ 8.5$ | $\$ 10.2$ |
| - Held in the United States | 9.9 | 10.6 | 9.8 |
| - Held by a foreign subsidiary | 21.2 | 19.1 | 20.0 |
|  | 60.5 | 59.4 | 57.4 |
| Working capital | 7.0 | 7.9 | 11.3 |
| Net cash provided by operating activities |  |  |  |
| Change in working capital impact on net cash | $(1.3)$ | $(0.1)$ | $(0.2)$ |
| provided by operating activities | $(2.3)$ | $(4.2)$ | $(5.5)$ |
| Net cash used in investing activities | $(3.4)$ | $(3.0)$ | $(4.0)$ |

During the first nine months of Fiscal 2014, the Company repatriated approximately $\$ 2.8$ million in cash from its foreign subsidiaries. The impact of this was an increase in the effective tax rate by approximately $1.4 \%$. U.S. income taxes have not been provided on the undistributed earnings of the Company's foreign subsidiaries except where required under U.S. tax laws. The Company would be required to accrue and pay United States income taxes to repatriate the funds held by foreign subsidiaries not otherwise provided. The Company intends to reinvest these earnings outside the United States indefinitely.

All cash held by foreign subsidiaries is readily convertible into other currencies, including the U.S. Dollar.

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Total inventories remained fairly constant at $\$ 30.7$ million on September 27, 2014 compared to $\$ 30.7$ million at year end 2013 and $\$ 30.4$ million at the end of the third quarter of 2013. Accounts receivable was $\$ 18.5$ million compared to $\$ 16.3$ million at year end 2013 and $\$ 18.7$ million at the end of the third quarter of fiscal 2013. The increase from year end is related to increased revenue in the current quarter as compared to the last quarter of Fiscal 2013.

Cash on hand, cash flow from operating activities and funds available under the revolving credit portion of the Company's Loan Agreement are expected to be sufficient to cover future foreseeable working capital requirements.

## ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk from what was reported in the 2013 Annual Report on Form $10-\mathrm{K}$.

## ITEM 4 - CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures:
As of the end of the quarter ended September 27, 2014, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer (the "CEO") and Chief Financial Officer (the "CFO"), of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 240.13a-15. As defined in Exchange Act Rules 240.13a-15(e) and $240.15 \mathrm{~d}-15(\mathrm{e})$, "the term disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Act ( 15 U.S.C. 78 a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure." Based upon that evaluation, the CEO and CFO concluded that the Company's current disclosure controls and procedures were effective as of the September 27, 2014 evaluation date.

The Company believes that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. The Company's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives, and the CEO and CFO have concluded that these controls and procedures are effective at the "reasonable assurance" level.

Changes in Internal Controls:
During the period covered by this report, there have been no significant changes in the Company's internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, the Company's internal controls.

## PART II - OTHER INFORMATION

## ITEM 1 - LEGAL PROCEEDINGS

During the fourth quarter of 2010, the Company was contacted by the State of Illinois regarding potential ground contamination at our plant in Wheeling, Illinois. The Company enlisted into a voluntary remediation program in Illinois and has engaged an environmental clean-up company to perform testing and develop a remediation plan, if needed. No estimate for the cost of remediation was available when this Form 10-Q was filed with the SEC.

During 2008, the U.S. Environmental Protection Agency identified the Company as a potentially responsible party in connection with a site in Cleveland, Ohio based on the ownership of the site by a division of the Company in the

1960's. According to the Agency, the current occupant of the site filed bankruptcy, leaving behind plating operations which required remedial action. The Company declined to participate in the remedial action, and intends to defend against any efforts of the Agency to impose any liability against the Company for environmental conditions on this site which may have occurred in the years since its ownership.

There are no other legal proceedings, other than ordinary routine litigation incidental to the Company's business, to which either the Company or any of its subsidiaries is a party or to which any of their property is the subject.

## ITEM 1A - RISK FACTORS

There have been no material changes in risk factors from what was reported in the 2013 Annual Report on Form 10-K.

## ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There have been no sales of unregistered securities by the Company or purchases of registered equity securities by the Company during the period covered by this report.

## ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None

## ITEM 4 - MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5 - OTHER INFORMATION

None

## ITEM 6 - EXHIBITS

31) Certifications required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32) Certifications pursuant to Rule 13a-14(b) and 18 USC 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99(1)) The Registrant's Annual Report on Form 10-K for the fiscal year ended December 28, 2013 is incorporated herein by reference.

99(2)) Form 8-K filed on April 23, 2014 setting forth the press release reporting the Company's earnings for the quarter ended March 29, 2014 is incorporated herein by reference.

99(3)) Form 8-K filed on April 24, 2014 setting forth the results of the vote at the annual meeting of shareholders of the Company which was held on April 23, 2014 is incorporated herein by reference.

99(4)) Form 8-K filed on July 23, 2014 setting forth the press release reporting the Company's earnings for the quarter ended June 28, 2014 is incorporated herein by reference.

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99(5)) Form 8-K filed on October 22, 2014 setting forth the press release reporting the Company's earnings for the quarter ended September 27, 2014 is incorporated herein by reference.

99(6)) Form 8-K filed on October 23, 2014 setting forth the amendment of the Employment Agreement dated December 18, 2013 with Leonard F. Leganza is incorporated herein by reference.
-21-

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DATE: October 24, 2014

DATE: October 24, 2014

THE EASTERN COMPANY
(Registrant)
/s/Leonard F. Leganza
Leonard F. Leganza
Chairman, President and Chief Executive Officer
/s/John L. Sullivan III
John L. Sullivan III
Vice President and Chief Financial Officer
-22-

